

General Information Letter: No credit is allowed for taxes paid to another state on compensation "paid in this State" under IITA Section 304(a)(2)(B).

March 29, 2005

Dear:

This is in response to your letter dated March 11, 2005, in which you request a redetermination of the credit allowable to you for taxes paid to other states for 2003. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at [www.revenue.state.il.us](http://www.revenue.state.il.us).

In your letter you have stated the following:

We are submitting this correspondence to, first, dispute why credit for taxes we paid to other states on 2003 Illinois income was removed seven months after filing and, second, request that credit for taxes paid to other states be re-applied and penalties, fines and interest accrued on the total tax liability be waived, abated and refunded.

A total of \$6,680 was withheld and paid in state taxes by Mr. and Mrs. Z, where \$3,607 was withheld and paid to Illinois and \$3,073 was withheld and paid to other states (Colorado, Minnesota and city of Denver). As done in prior years, a Schedule CR was completed and submitted with 2003 Form IL-1040 along with all W2s to gain credit for taxes paid to other states. Upon completing Schedule CR, we figured a total credit of \$1,750 and reflected that amount on our 2003 Form IL-1040, line 19.

It was not until we received an ITR-85 Individual Income Tax First and Final Bill notice on October 18, 2004 that we concluded there was some discrepancy. As we did not receive any error notices explaining the potential issues or errors, we did not understand the reasoning for the bill. We followed up with the Illinois Department of Revenue on October 21 via phone and spoke to a Mr. Jacobs. Mr. Jacobs explained that there was no record of Mrs. Z's W-2 on file or of the Illinois taxes she paid via withholdings.

Immediately following our conversation with Mr. Jacobs we responded with a letter dated October 21 to the Illinois Department of Revenue and forwarded another copy of Mrs. Z's W2 showing Illinois income state tax withholding. We requested that our records be updated to show the accurate and total amount of money paid to the state of Illinois for Mr. Z and Mrs. Z's 2003 Illinois state taxes, in addition to the tax monies paid to other states.

On October 25 we received an LTR-402 Error Notice Response from Terry Lindsey indicating that the credit for taxes paid to other states was applied, however, the credit amount was changed from \$1,750 to \$1,701. (The reason for this \$49 change was never given to us). Additionally, Mr. Lindsey indicated that line 17, total amount of Illinois income tax withheld, was changed from \$3,607 to \$1,809 because a W2

showing Illinois withholding for Mrs. Z was not provided.

We followed up again on October 28 at 3:37 p.m. to ensure the matter was resolved. During this conversation, we spoke with Mr. Lindsey and he confirmed that the W2 for Mrs. Z showing Illinois withholding was received. Mr. Lindsey told us to "sit tight" as the process would take a few weeks and that we would be contacted by the Illinois Department of Revenue post processing.

We never received contact from the department and again proactively followed up with a phone call on December 6 at 4:25 p.m. An agent, Jim, told us that the matter was "still processing" and we should continue to "just wait."

On February 10, 2005, at 4:08 p.m., we proactively followed up again and spoke to Barry. Barry indicated that our records, at that time, were showing a credit of \$3,607 on Line 17, Illinois Income Tax withheld from pay, which included the correct withholdings shown on Mrs. Z's W2 that they received, and a credit of \$313 (that was tax due to Illinois based on completion of our 2003 Form IL-1040 which was submitted via check on April 12, 2004 at time of 2003 filing). However, the credit for taxes paid to other states of \$1,701 was "taken away." Barry did not know why the credit was taken away and had no further explanation.

We then asked to be transferred to a supervisor and spoke to Linda Bennett (February 10 at 4:20 p.m.). Linda said she would "look into it on Monday." On February 15 at 9:50 a.m., we called Linda to follow up and she indicated that we "should receive credit" and that she was "not sure why the \$1,701 was removed." On the same day but later in the afternoon, February 15, at 4:35 p.m., we followed up with Linda again in hopes that she was successful in resolving the issue and she said that "it will be ok."

On February 16, in hopes of getting final resolution and confirmation of credit for taxes paid to other states, we followed up again and spoke to Terry Lindsey at 4:10 p.m. and were told that "legal overrode both Terry Lindsey and Linda Bennett and that the credit was not applicable and that the total amount due was \$2,576.67." Terry explained that this amount was for the outstanding tax liability – since the credit for taxes paid to other states was not given – plus penalties, fines and accrued interest.

Upon receipt of this extremely upsetting news, we submitted a check for \$2,576.67 to the Illinois Department of Revenue on February 16, 2005 to mitigate further accrued fines and collection activity. However we are, as stated earlier, disputing our case.

First, we do not understand why we are not receiving credit for taxes paid to other states. Without receiving this credit, we are in effect paying double tax on Illinois earned income. This is unfair and unjust. We have enclosed copies of all W2s, Schedule CR and payments made to the Illinois Department of Revenue. We ask that you please re-review these documents and our case and correctly apply due credit for taxes paid to other states. If we are not eligible for credit for taxes paid to other states, then please furnish us a written reason per Illinois state tax law.

Second, in the event we that Illinois tax law determines we are not eligible for credit for taxes paid to other states, then we at least request the fines, penalties and accrued interest associated with the tax liability amount, for a total of \$826.67, be waived and abated, and reimbursed to us.

It is our understanding, per the February 16 conversation with Terry Lindsey, that the tax due was \$2,063 (because credit for taxes paid to other states was not applied). Per our original 2003 tax calculations and filing, we submitted a payment of \$313 on April 12, 2004 (check number 1490). This resulted in a balance of \$1,750 (because credit for taxes paid to other states was not granted). Additionally, as noted earlier, we submitted another payment of \$2,576.67 on February 16, 2005 (check number 1851) covering both the tax liability balance of \$1,750 and accrued penalties, fees and interest totaling \$826.67.

We never received an error notice and were not notified of an issue even existing until October 18 with receipt of the ITR-85 Individual Income Tax First and Final Bill correspondence. As we were not notified of an error or outstanding tax liability until six months after tax filing and resolution of the issue did not occur until four months following the initial notification we received, any penalties, fines and accrued interest applied during this 10 month period is also unjust and unfair.

It is unreasonable for the Illinois state government to accrue penalties, fines and interest on an outstanding tax amount that we are not made aware of or while the amount is under case review and pending resolution.

We are lifetime Illinois residents who have been diligent taxpayers since our first days of employment and income earning. We have always paid our fair share of taxes without question and on time. However, this time – for our 2003 taxes – we feel we have unfairly paid double tax and have also paid for penalties and fines that have been unjustly applied.

Again, we ask that your please re-review our case and supplied documents and find that the credit for taxes paid to other states is reapplied to our records, penalties, fines and accrued interest is waived and abated, and that tax overpayment and penalties and fines in the amount of \$2,576.67 be reimbursed.

### **Response**

Section 601(b)(3) of the Illinois Income Tax Act (35 ILCS 5/601), in part:

The aggregate amount of tax which is imposed upon or measured by income and which is paid by a resident for a taxable year to another state or states on income which is also subject to the tax imposed by subsections 201(a) and (b) of this Act shall be credited against the tax imposed by subsections 201(a) and (b) otherwise due under this Act for such taxable year. The aggregate credit provided under this paragraph shall

not exceed that amount which bears the same ratio to the tax imposed by subsections 201(a) and (b) otherwise due under this Act as the amount of the taxpayer's base income subject to tax both by such other state or states and by this State bears to his total base income subject to tax by this State for the taxable year. *For purposes of this subsection, no compensation received by a resident which qualifies as compensation paid in this State as determined under Section 304(a)(2)(B) shall be considered income subject to tax by another state or states.* (emphasis added)

Section 1501(a)(3) of the Illinois Income Tax Act (35 ILCS 5/1501) defines "compensation" to mean "wages, salaries, commissions and any other form of remuneration paid to employees for personal services. Thus, under Section 601(b)(3), you are not allowed a credit for taxes paid to another state on Mrs. Z's salary if, under Section 304(a)(2)(B) of the Illinois Income Tax Act (35 ILCS 5/304), that salary was "paid in this State." Section 304(a)(2)(B) provides, in part:

Compensation is paid in this State if:

- (i) The individual's service is performed entirely within this State;
- (ii) The individual's service is performed both within and without this State, but the service performed without this State is incidental to the individual's service performed within this State; or
- (iii) Some of the service is performed within this State and either the base of operations, or if there is no base of operations, the place from which the service is directed or controlled is within this State, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this State.

Under subparagraph (iii), the compensation Mrs. Z earned while working in Colorado and Minnesota would be "paid in this State," and thus not eligible for the credit, if her base of operations was in Illinois during the year or if she had no base of operations, but her services were directed or controlled by a supervisor in Illinois.

Section 701(a)(1) of the Illinois Income Tax Act (35 ILCS 5/701) requires withholding from compensation "paid in this State" under Section 304(a)(2)(B). Accordingly, when COMPANY reported on the Form W-2 that all of Mrs. Z's compensation for 2003 was Illinois income, that is evidence that all of the compensation was paid in this State and therefore not eligible for credit. After we received the missing Form W-2, the credit was properly denied.

In order to show that you are entitled to the credit, you will need to obtain a written statement from COMPANY, explaining that the Form W-2 is in error and what the correct amount of salary "paid in this State" for the year was. We have had this issue with a number of COMPANY employees, and Ms. Y of COMPANY is familiar with the issues involved and has been very helpful in the past. I would suggest you call her for assistance in this matter. She can be reached at (913) 319-1258.

If you do obtain some evidence showing that Mrs. Z's income does qualify for the credit, please

contact me. Even if you concede that the income does not qualify, you may still be able to have the late payment penalties abated. To obtain abatement of the penalties, you should file a petition with the Board of Appeals on Form BOA-1, which can be found on our web site at [www.revenue.state.il.us/taxforms/misc/boa/boa1.pdf](http://www.revenue.state.il.us/taxforms/misc/boa/boa1.pdf).

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton  
Deputy General Counsel – Income Tax